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In the Supreme Court of the United States

OCTOBER TERM, 1982

SOONER FEDERAL SAVINGS AND LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION, AND FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LAWTON, APPELLANTS

v.

OKLAHOMA TAX COMMISSION AND THE STATE OF OKLAHOMA

ON APPEAL FROM THE SUPREME COURT OF OKLAHOMA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING DISMISSAL

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QUESTIONS PRESENTED

1. Whether dividends paid to appellants on their shares of Federal Home Loan Bank stock are exempt from state income taxation under Section 13 of the Federal Home Loan Bank Act, 12 U.S.C. 1433.

2. Whether dividends paid to appellants on their shares of Federal Home Loan Bank stock are exempt from state income taxation under Section 3701 of the Revised Statutes, 31 U.S.C. 742.

TABLE OF CONTENTS

Page

Opinions below 1

Jurisdiction 1

Statutory provisions involved 3

Statement 3

Argument 5

Conclusion 11

TABLE OF AUTHORITIES

Cases:

Ayer v. *Commissioner*, 12 B.T.A. 284 7

First Federal Savings & Loan Ass'n v. *Department of Revenue*, 654 P.2d 496 9

First Federal Savings & Loan Ass'n v. *Tax Commissioner*, 437 U.S. 255 6

Laurens Federal Savings & Loan Ass'n v. *South Carolina Tax Commission*, 365 U.S. 517 7

Miller v. *Milwaukee*, 272 U.S. 713 7

Pittman v. *Homeowners' Loan Corp.*, 308 U.S. 21 7

Smith v. *Davis*, 323 U.S. 111 9-10

Weston v. *City Council* 27 U.S. (2 Pet.) 449 10

Statutes and regulations:

Act of Feb. 25, 1862, ch. 33, Section 2, 12 Stat. 345 10

Page

Statutes and regulations—Continued:

Act of Sept. 6, 1966, Pub. L. No. 89-554, Section 8(a), 80 Stat. 648 8

Act of Dec. 10, 1971, Pub. L. No. 92-181, Section 5.26(a), 85 Stat. 624 7

Federal Farm Loan Act, 12 U.S.C. (1970 ed.) 931 7

Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1421 *et seq.*:

- Section 2(4), 12 U.S.C. 1422(4) 3
- Section 3, 12 U.S.C. 1423 3
- Section 4, 12 U.S.C. 1424 3
- Section 6(c), 12 U.S.C. 1426(c) 3
- Section 6(c)(2)(ii), 12 U.S.C. (Supp. V) 1426(c)(2)(ii) 4
- Section 6(k), 12 U.S.C. 1426(k) 4
- Sections 9-13, 12 U.S.C. (& Supp. V) 1429-1433 3
- Section 10(c), 12 U.S.C. 1430(c) 4
- Section 13, 12 U.S.C. 1433 ..... 3, 4, 5, 6, 8, 9
- Section 16, 12 U.S.C. 1436 4
- Section 17(a), 12 U.S.C. 1437(a) 3

Federal Reserve Act, 12 U.S.C. 531 7

Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 128, 12 U.S.C. 1461 *et seq.*:

- Section 4(c), 48 Stat. 129 8
- Section 5(h), 48 Stat. 133 (12 U.S.C. 1464(h)) 3, 5, 6

Public Debt of 1942, 31 U.S.C. 742(a) 3, 8

Page

Statutes and regulations—Continued:

Rev. Stat. 3701 (1878 ed.)
(31 U.S.C. 742) 3, 5, 6, 9, 10

12 U.S.C. 2055 7

Treasury Regulations on Income Tax (1954 Code)
(26 C.F.R.):

Section 1.103-2(a) 7, 8
Section 1.312-6(b) 7

Treas. Reg. 118, § 39.22(b)(4)-2
(1939 Code) 8

Miscellaneous:

Cong. Globe, 37th Cong., 2d Sess. (1862):

p. 615 10
pp. 763-765 10
pp. 775-780 10
pp. 889-902 10

1 J. Mertens, *Law of Federal Income Taxation*
(1981) 7

S. Rep. No. 1173, 77th Cong., 2d Sess.
(1943) 8

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This brief is submitted in response to the Court's invitation to the Solicitor General to express the views of the United States.

OPINIONS BELOW

The order of the Oklahoma Tax Commission (J.S. App. 11-A to 15-A) and the opinion of the Supreme Court of the State of Oklahoma (J.S. App. 1-A to 10-A) are not officially reported.

JURISDICTION

The jurisdiction of this Court is invoked by appellants (J.S. 3) under 28 U.S.C. 1257(2), which provides for review of final judgments of the highest court of a state in this Court by appeal "where is drawn in question the validity of

a statute of any state on the ground of its being repugnant to the * * * laws of the United States, and the decision is in favor of its validity." See *First Federal Savings & Loan Ass'n* v. *Tax Commission*, 437 U.S. 255 (1978); *Reconstruction Finance Corp.* v. *Beaver County*, 328 U.S. 204, 206-207 (1946).

The judgment of the Supreme Court of Oklahoma in favor of the validity of statutes of the State of Oklahoma, the validity of which as applied was drawn in question on the ground of repugnance to the laws of the United States, was entered on October 5, 1982. The notice of appeal to this Court was filed on October 14, 1982 (J.S. 2-3; J.S. App. 16-A to 17-A). The jurisdictional statement was filed on November 29, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).[1]

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[1]Appellees argue (Mot. to Dis. 2-4) that review of the decision below can only be sought by writ of certiorari because appellants failed to attack the validity of a state statute within the meaning of 28 U.S.C. 1257(2). In appellees' view, the Oklahoma Tax Commission's order was an adjudicatory order and not a "statute" under 28 U.S.C. 1257(2). But it is plain that "the jurisdictional provision uses the words 'a statute of any State' in their larger sense and is not intended to make a distinction between acts of a state legislature and other exertions of the State's law-making power, but rather to include every act legislative in character to which the State gives its sanction" *King Manufacturing Co.* v. *City Council*, 277 U.S. 100, 104-105 (1928), quoted in *Lathrop* v. *Donohue*, 367 U.S. 820, 824 (1961) (plurality opinion). Here, appellants argue that the Oklahoma tax statutes are repugnant to their claimed federal statutory right to tax exemption from state tax on the dividends they received on Federal Home Loan Bank stock, and both the Oklahoma Tax Commission and the Supreme Court of Oklahoma ruled in favor of the validity of the state statutes as applied. Like the orders integrating the Bar in Wisconsin considered by the Court in *Lathrop* v. *Donohue*, *supra*, this ruling below necessarily applies to every similarly situated savings and loan association in Oklahoma and accordingly "ha[s] the characteristics of legislation" (367 U.S. at 827). The appeal is therefore cognizable under Section 1257(2). See also *Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U.S. 282 (1921); *Bantam Books, Inc.* v. *Sullivan*, 372 U.S. 58, 61 n.3 (1963); *Cohen* v. *California*, 403 U.S. 15, 17-18 (1971).

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Federal Home Loan Bank Act, Section 13, 12 U.S.C. 1433; the Home Owners' Loan Act of 1933, Section 5(h), 12 U.S.C. 1464(h); the Rev. Stat. 3701 (1878 ed.), (31 U.S.C. 742); and the Public Debt Act of 1942, 31 U.S.C. 742(a), are set forth in J.S. App. 35-A to 36-A, 39A.

STATEMENT

Appellants are federal savings and loan associations (J.S. App. 2-A). They are chartered and regulated by the Federal Home Loan Bank Board, an independent federal agency created by Congress in 1932 and invested with authority to supervise and regulate, *inter alia,* the Federal Home Loan Bank System. Section 17a, Federal Home Loan Bank Act, 12 U.S.C. 1437(a). That bank system is comprised of 12 regional banks (12 U.S.C. 1423) and was created by Congress to meet the needs of the housing market in the United States by furnishing, at favorable rates, credit facilities for savings and loan associations and other eligible member financial institutions (J.S. App. 2-A to 3-A). See also 12 U.S.C. (& Supp. V) 1429-1433.

As a condition of membership in the bank system, appellants were required to own shares of stock (the amount of which was established according to a formula established by Congress) in one of the regional Federal Home Loan Banks. Sections 2(4), 4 and 6(c), Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1422(4), 1424, 1426(c). "The original stock subscription of each institution eligible to become a member * * * [is] an amount equal to 1 per centum of the subscriber's aggregate unpaid loan principal, but not less than $500." Section 6(c), Federal Home Loan Bank Act, 12 U.S.C. 1426(c). In order to obtain advances

from a Federal Home Loan Bank, member institutions must purchase additional shares of stock above and beyond that which is required as a condition of membership. Section 10(c), Federal Home Loan Bank Act, 12 U.S.C. 1430(c). The amount of such additional stock ownership is directly related to the amount of advances a member institution obtains from a Federal Home Loan Bank (Sections 6(c)(2)(ii) and 10(c), Federal Home Loan Bank Act, 12 U.S.C. (& Supp. V) 1426(c)(2)(ii) and 1430(c); J.S. App. 2-A to 3-A.

All shares of stock in the bank system are entitled to share in dividend distributions without preference. Section 6(k), Federal Home Loan Bank Act, 12 U.S.C. 1426(k). Such dividends are paid out of the net earnings remaining after providing for all reserves and charge-offs required by law. Section 16, Federal Home Loan Bank Act, 12 U.S.C. 1436. Appellants reported and paid Oklahoma corporation income taxes for the years 1972, 1973 and 1974 in the aggregate amount of $13,802.12 on the dividends on their shares of Federal Home Loan Bank stock (J.S. App. 2-A).

Appellants subsequently claimed that the dividends from their Federal Home Loan Bank stock were not subject to state income tax. In their claims for refund of these taxes, appellants claimed that the dividends paid on their shares of Federal Home Loan Bank stock were exempt from state tax under Section 13, Federal Home Loan Bank Act, 12 U.S.C. 1433, which exempts from state income taxation as to principal and interest all notes, debentures, bonds and other such obligations issued by any Federal Home Loan Bank, and further exempts from state taxation the Federal Home Loan Bank, "including its franchise, its capital, reserves and surpluses, its advances, and its income." Appellants contended that the dividends distributed on the Federal Home

Loan Bank stock were exempt under Section 13 as the net income of the Federal Home Loan Bank. Appellants also claimed exemption for such dividends from state income taxation under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742) which exempts from state income taxation all stocks, bonds, Treasury notes and other obligation of the United States, and interest paid on such instruments. Finally, appellants apparently contended that the dividends paid on Federal Home Loan Bank stock were exempt from state taxation as a tax on the stock of federal instrumentalities (J.S. App. 3-A to 4-A, 6-A, 14-A; Mot. to Aff. App. A-1 to A-4).

The Oklahoma Tax Commission held that the dividends received by appellants on their shares of Federal Home Loan Bank stock were not exempt from tax under Section 13, Federal Home Loan Bank Act, and that the Section did not prohibit the taxation of income of federally chartered savings and loan associations. The Tax Commission found that the state income tax imposed on the dividends in question was authorized by Section 5(h), Home Owners' Loan Act of 1933, 12 U.S.C. 1464(h), which provides in pertinent part that "No State * * * shall impose any tax on such associations or their income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions" (J.S. App. 14-A). The Supreme Court of the State of Oklahoma affirmed on the same ground (J.S. App. 5-A to 10-A). Neither the Tax Commission nor the Oklahoma Supreme Court addressed appellants' contentions under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742).

ARGUMENT

The decision of the Supreme Court of the State of Oklahoma is correct and appellants do not present any substantial federal question warranting plenary review.

Appellants' status as federally chartered savings and loan associations does not exempt them from state income taxation. Section 5(h), Home Owners' Loan Act of 1933, 12 U.S.C. 1464(h); *First Federal Savings & Loan Ass'n* v. *Tax Commission* 437 U.S. 255, 260 (1978). Thus, unless some statutory provision exempts from state income tax the dividends paid on appellants' shares of Federal Home Loan Bank stock, those dividends are subject to the Oklahoma income tax. Appellants claim (J.S. 8-11) that the dividends paid on Federal Home Loan Bank stock are exempt from such tax under Section 13, Federal Home Loan Bank Act, 12 U.S.C. 1433 (J.S. 8-11), and under Rev. Stat. 3701 (1878 ed.) (31 U.S.C. 742) (J.S. 11-14). For the reasons that follow, we submit that neither provision supports the claimed exemption.

1. Section 13 of the Federal Home Loan Bank Act exempts from state taxation the principal and interest of "[a]ny and all notes, debentures, bonds, and other such obligations" issued by any Federal Home Loan Bank. That Section further provides that any such "bank, including its franchise, its capital, reserves, and surplus, its advances, and its income" shall be exempt from state taxation. Nothing in that Section expressly precludes the taxation by Oklahoma of dividends paid on shares of Federal Home Loan Bank stock. Nor are we aware of any legislative history expressly purporting to exempt from state income taxation the dividends paid on such shares of stock. What that Section does is to preclude the state taxation of debt instruments of the Federal Home Loan Banks and the interest paid on such instruments and to preclude the taxation of the Federal Home Loan Banks. When Congress has foreclosed the state taxation of dividends paid on shares of

stock of one of its instrumentalities, it has done so specifically. For example, the capital stock in the Federal Reserve Bank and "the income derived" from such stock is specifically exempt from state income taxation. Federal Reserve Act, 12 U.S.C. 531. Likewise, the dividends on shares of stock held in Federal Land Banks is exempt from state taxation. See Federal Farm Loan Act, Section 26, 12 U.S.C. (1970 ed.) 931 (repealed by the Act of Dec. 10, 1971, Pub. L. No. 92-181, Section 5.26(a), 85 Stat. 624). See also 12 U.S.C. 2055.

Appellants argue (J.S. 8-11) that the dividends on shares of Federal Home Loan Bank stock are exempt under Section 13 because the dividends represent a distribution of the Federal Home Loan Bank's income, which is exempt from state taxation. We disagree. Although the dividends are paid out by the Federal Home Loan Bank from its earnings, we do not believe that they are the income of the Federal Home Loan Bank. Rather, they are the income of the stockholder, viz., appellants. And the stockholder's income is not exempt from state income taxation. Cf. Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.), Section 1.312-6(b); see *Ayer* v. *Commissioner*, 12 B.T.A. 284 (1928); 1 J. Mertens, *Law of Federal Income Taxation*, § 9.32 (1981). Since the Oklahoma tax applies equally to the stockholders of all corporations, this case comes within the general rule that "a corporation is a nonconductor that cuts off connection between dividends to its stockholders and the corporate funds from which the dividends are paid." *Miller* v. *Milwaukee*, 272 U.S. 713, 714 (1927).

Laurens Federal Savings & Loan Ass'n v. *South Carolina Tax Commission*, 365 U.S. 517 (1961), and *Pittman* v. *Home Owners' Loan Corp.*, 308 U.S. 21 (1939), upon which appellants rely (J.S. 10-11), are distinguishable. In *Laurens*, this Court held that a state documentary stamp

tax upon promissory notes executed by a federal savings and loan association to evidence advances it received from a Federal Home Loan Bank violated Section 13 of the Federal Home Loan Bank Act, because it was a tax upon the advance itself of the Federal Home Loan Bank, and therefore specifically exempted from state taxation by Section 13. The fact that the documentary stamp tax was to be paid by the federal savings and loan association and not by the Federal Home Loan Bank was deemed irrelevant. In *Pittman,* the Court ruled that a Maryland stamp tax upon mortages executed by the Home Owners' Loan Corporation violated the virtually identical provision of Section 4(c) of the Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 129 (now repealed by the Act of Sept. 6, 1966, Pub. L. No. 89-554, Section 8(a), 80 Stat. 648). Although the purchase of stock (and perforce an advance) is an integral part of the entire advance mechanism of the Federal Home Loan Bank, we do not believe that a tax on the dividends paid on such stock is comparable to an excise tax on advances of the types considered in *Laurens* and *Pittman.*[2]

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[2]Contrary to appellants' suggestion (J.S. 12), there is no support for their claim of state tax exemption in the legislative history of the Public Debt Act of 1942, 31 U.S.C. 742(a) which removed the tax exempt status for federal tax law purposes (unless otherwise provided in the Internal Revenue Code) of dividends, earnings or other income from shares, certificates, stock or other evidences of ownership issued by the United States or any federal agency or instrumentality thereof. See S. Rep. No. 1173, 77th Cong., 2d Sess. 3 (1943). That Act merely removed specific tax-exempt privileges (from federal taxes) on dividends on shares of stock and other evidences of ownership issued by various agencies and instrumentalities of the United States. No such privilege existed with respect to dividends on shares of Federal Home Loan Bank stock prior to the 1942 Act.

We acknowledge that beginning with Section 39.22(b)(4)-2, Treas. Reg. 118 (1939 Code), and continuing in Section 1.103-2(a), Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.), dividends on shares of Federal Home Loan Bank stock issued prior to March 28, 1942, have been exempt from federal income tax on the ground that

We therefore believe that Section 13 of the Federal Home Loan Bank Act does not prohibit the imposition of a state income tax on the dividends paid on shares of Federal Home Loan Bank stock.

2. Appellants' further reliance (J.S. 11-14) upon Rev. Stat. 3701 (1878 ed.) 31 U.S.C. 742), as a basis for an exemption from the state income tax on the dividends of Federal Home Loan Bank stock is misplaced. That Section exempts from state taxation, with certain inapplicable exceptions, "all stocks, bonds, Treasury notes, and other obligations of the United States" both as to principal and "the interest thereon." That statute grants exemption only to interest-bearing obligations authorized by Congress (*Smith* v. *Davis*, 323 U.S. 111, 118-119 (1944)), not to the shares of stock representing equity ownership in the Federal Home Loan Bank upon which dividends may or may not be paid depending upon the profitability of the Federal Home Loan Bank.

Section 3701 is derived from seven statutory exemptions, six of which were enacted during the Civil War, and the seventh in 1870. See *Smith* v. *Davis*, *supra*, 323 U.S. at 117

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they were exempt prior to the Public Debt Act of 1942 under 12 U.S.C. 1433. Whatever the statutory justification for this statement in the Regulations, it has no controlling effect here for it deals with exemption from federal income tax, not state income tax.

See also *First Federal Savings & Loan Ass'n* v. *Department of Revenue*, 654 P.2d 496 (Mont. 1982). The court's opinion was addressed to "interest income from certain federal obligations" (*id.* at 497) and held such "interest income from the federal obligations indicated" (*id.* at 497) to be exempt from the state income tax pursuant to 31 U.S.C. 742. The table appearing (654 P.2d at 497) in the court's opinion indicates that some $48,000 in dividends on Federal Home Loan Bank stock was included in the $221,000 "interest income" at issue. To the extent that the court was unaware of the heterogeneous nature of the income at issue, its decision is not authoritative for purposes of the questions presented here. To the extent that it was so aware, we believe its decision was erroneous.

n.7, which lists the statutes and quotes the exempting provisions. Those exemption provisions were enacted in statutes authorizing the Secretary of the Treasury to borrow large amounts on the credit of the United States, and had as their purpose to prevent taxes, "which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith* v. *Davis, supra,* 323 U.S. at 117.

Of the statutes from which Section 3701 was derived, only the Act of Feb. 25, 1862, ch. 33, Section 2, 12 Stat. 345, used the word "stocks." It provided exemption from state taxation for "all stocks, bonds, and other securities of the United States." The term "stock" was used in the congressional debates to refer to interest-bearing securities of the public debt of the federal government. Cong. Globe, 37th Cong., 2d Sess. 615, 763-765, 775-800, 889-902 (1862). As this Court pointed out in *Smith* v. *Davis, supra,* 323 U.S. at 118 n.8, the exemption provided by the Act of Feb. 25, 1862, embraced " 'simply the public securities, such as are described as the permanent debt of the Government.' Cong. Globe, p. 3184, 38th Cong., 1st Sess." Indeed, in this context the term "stock" was used during the Nineteenth Century to refer to interest-bearing securities of the public debt of the federal government. See the various Acts cited in *Smith* v. *Davis, supra,* 323 U.S. at 115. "The stock it [the Federal Government] issues is the evidence of a debt * * *." *Weston* v. *City Council,* 27 U.S. (2 Pet.) 449, 465 (1829). Accordingly, the term "stock" in Rev. Stat. 3701 (1878 ed.), does not cover dividend-paying shares of Federal Home Loan Bank stock.

CONCLUSION

The appeal should be dismissed for want of a substantial federal question.

Respectfully submitted.

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